

## Message Text

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PAGE 01 ROME 02177 101124Z  
ACTION SS-25

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S E C R E T ROME 2177

EXDIS

PASS FRB

E.O. 11652: GDS  
TAGS: EFIN, ECON, IT  
SUBJECT: EMBASSY RECOMMENDATIONS ON FOREIGN FINANCING IN SUPPORT  
OF ITALIAN STABILIZATION PROGRAM

REF: (A) ROME 2175, (B) ROME 2176

1. SUMMARY. FOLLOWING CONTAINS EMBASSY SUMMARY COMMENTS ON  
ITALIAN STABILIZATION PROGRAM AND RECOMMENDATION ON FOREIGN  
FINANCING WHICH SEEMS JUSTIFIED BY THAT PROGRAM. DETAILED  
ECONOMIC ANALYSIS AND ASSESSMENT IS CONTAINED REFTEL A.  
ESSENTIAL CONCLUSION IS THAT GOI HAS MADE GOOD START ON PROGRAM  
TO DEAL WITH ITALY'S FUNDAMENTAL ECONOMIC PROBLEMS. STABILIZATION  
PROGRAM NOW IN PLACE WILL BE SUFFICIENT TO SLOW DOWN ECONOMY IN  
1977, RE-ESTABLISH APPROXIMATE BALANCE IN CURRENT ACCOUNT OF  
BALANCE OF PAYMENTS AND DECELERATE RATE OF INFLATION. HOWEVER,  
UNLESS FURTHER ACTION IS TAKEN, ESPECIALLY ON PUBLIC SECTOR  
SPENDING AND ON LABOR COSTS PROGRAM WILL PROBABLY DO NO MORE  
THAT PROVIDE TEMPORARY BREATHING SPACE BUT NOT RESOLVE UNDERLYING  
ECONOMIC PROBLEMS. ACCORDINLY, WE CONCLUDE THAT, WHILE A MORE  
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PAGE 02 ROME 02177 101124Z

SUBSTANTIAL PROGRAM COULD HAVE BEEN HOPED FOR, QUALITY AND MAG-  
NITUDE OF GOI EFFORT AND OF PROGRAM, PLUS POLITICAL/ECONOMIC  
ADVANTAGE OF CONTINUING SUPPORT OF ANDREOTTI GOVERNMENT, ARE  
SUFFICIENT TO WARRANT SMALL IMF STANDBY PHASED OVER 1977 AS WELL  
AS SOME REFINANCING AND SHORT-TERM CREDIT LINES. END SUMMARY.

2. ECONOMIC EFFECTS OF PROGRAM. EMBASSY ESTIMATES THAT

STABILIZATION PROGRAM NOW IN PLACE WILL HAVE EFFECT OF REDUCING PROSPECTIVE DISPOSABLE PERSONAL INCOME BY ABOUT 6,700 BILLION LIRE; FINANCIAL POSITION OF BUSINESSES WOULD IMPROVE BY ABOUT 2,700 BILLION LIRE AND TREASURY CASH BUDGET WOULD BENEFIT BY ABOUT 4,000 BILLION LIRE. THESE TRANSFERS OF RESOURCES WOULD RESULT IN SLOWDOWN OF ECONOMIC GROWTH IN 1977 BY MINUS 1.2 PERCENT (GDP IN REAL TERMS). CURRENT ACCOUNT OF BALANCE OF PAYMENTS WOULD BE IN SMALL DEFICIT OF ABOUT \$200 MILLION AND OVERALL BALANCE WOULD BE IN DEFICIT BY ABOUT \$1.5 BILLION. RATE OF INCREASE IN COST OF LIVING WOULD DECLINE (DECEMBER TO DECEMBER RATE) TO ABOUT 12.0 TO 13.5 PERCENT (COMPARED TO 21.8 PERCENT IN 1976). EVEN WITH SMALL DECLINE IN GDP, TOTAL LEVEL OF ECONOMIC ACTIVITY IN 1977 WOULD STILL BE SECOND HIGHEST IN ITALY'S HISTORY. NONETHELESS, THERE COULD BE SOME INCREASE IN UNEMPLOYMENT AND IN SHORT-TIME WORK.

3. POLITICAL/ECONOMIC CONSIDERATIONS. APART FROM EMBASSY BELIEF THAT EXISTING PROGRAM IS SUFFICIENTLY GOOD TO MERIT MODEST FINANCIAL ASSISTANCE NOW, POLITICAL/ECONOMIC CONSIDERATIONS ALSO CALL FOR POSITIVE RESPONSE TO ITALIAN EFFORT. CLEARLY, CONTINUED STABILIZATION EFFORT IS NEEDED ON ECONOMIC GROUNDS. POLITICAL CRISIS AT THIS TIME WOULD INTERRUPT AND IMPEDE PURSUIT OF STABILIZATION GOALS. IT WOULD BE UNWISE, THEREFORE, EITHER TO REJECT OUTRIGHT ANY REQUEST FOR ASSISTANCE OR TO PORTRAY WHATEVER ASSISTANCE IS GIVEN AS BEING SUFFICIENT TO REMOVE NEED FOR FURTHER ACTION. IF IMF WERE TO REFUSE NEW STANDBY, THEN EFFORTS OF ANDREOTTI GOVERNMENT WOULD BE SEEN TO HAVE FAILED AND LIKELIHOOD OF A GOVERNMENT CRISIS WOULD INCREASE. THERE WOULD BE GREAT PRESSURE FOR AN "EMERGENCY GOVERNMENT", WHICH WOULD BE A COALITION

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SECRET

PAGE 03 ROME 02177 101124Z

OF ALL MAJOR PARTIES (INCLUDING THE PCI, BUT EXCLUDING THE NEO-FASCISTS). SUCH A GOVERNMENT WOULD BE DEPICTED AS ONLY POSSIBLE WAY OF DEALING WITH ECONOMIC PROBLEMS. IF, ON OTHER HAND, MODEST FINANCING CAN BE MADE AVAILABLE WITH UNDERSTANDING THAT CONTINUED GOOD PERFORMANCE COULD PRODUCE ADDITIONAL ASSISTANCE, THEN PROSPECTS OF IMPROVING STABILIZATION PROGRAM AS WELL AS POLITICAL STABILITY WILL HAVE BEEN ENHANCED.

4. FOREIGN FINANCING. IN CONCLUSION, EFFORT MADE BY GOI IN ADOPTING STABILIZATION PROGRAM IN FACE OF GREAT ODDS AND SIZE OF PROGRAM ITSELF JUSTIFY MODERATE AMOUNT OF FOREIGN FINANCING, QUITE APART FROM ANY POLITICAL CONSIDERATIONS. EMBASSY BELIEVES THAT QUALITY OF PROGRAM MERITS: (A) RELEASE BY EC OF \$500 MILLION LOAN TO OFFSET \$487 MILLION UK LOAN REPAYMENT; (B) ROLL-OVER OF ABOUT \$825 MILLION IN 1974 IMF STANDBY REPAYMENT; (C) SDR 450 MILLION NEW IMF STANDBY, WITH RELEASE OF FUNDS IN AT LEAST TWO TRANCHES, OF WHICH SECOND TRANCHE SHOULD BE TIED TO COMPLIANCE WITH STANDBY CONDITIONS AND TO MID-YEAR REVIEW OF RESULTS OF PRESENT PROGRAM PLANNED BY GOI, AND (D) MODEST SHORT-

TERM LINES OF CREDIT TO INSURE AGAINST POSSIBLE LARGE OUTFLOW OF  
SHORT-TERM CAPITAL OVERHANG IN NEXT FEW MONTHS.

5. WHATEVER FINANCIAL ASSISTANCE IS PROVIDED SHOULD CLEARLY  
BE ACCOMPANIED BY STATEMENT BY IMF AND OTHER FOREIGN CREDITORS  
THAT, WHILE PRESENT PROGRAM IS STEP IN RIGHT DIRECTION, IT IS NOT  
SUFFICIENT TO RESOLVE ITALY'S FUNDAMENTAL ECONOMIC PROBLEMS.  
ITALIAN PUBLIC, UNIONS AND POLITICAL PARTIES SHOULD NOT BE LULLED  
INTO THINKING THAT STABILIZATION JOB IS DONE. IN SHORT, PRESSURE  
MUST BE KEPT ON ITALIANS TO PERSIST IN STABILIZATION EFFORT IF  
THEY EXPECT TO RESOLVE STRUCTURAL IMPEDIMENTS TO NON-INFLATIONARY  
GROWTH, AND IT SHOULD BE MADE CLEAR TO THEM THAT FURTHER ASSIS-  
TANCE DEPENDS ON THIS.BEAUDRY

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## Message Attributes

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